

**STATE OF NORTH DAKOTA  
BISMARCK, NORTH DAKOTA**

**REPORT OF EXAMINATION  
OF**

**HEART OF AMERICA HMO  
RUGBY, NORTH DAKOTA**

**AS OF  
DECEMBER 31, 2002**

STATE OF NORTH DAKOTA  
DEPARTMENT OF INSURANCE

I, the undersigned, Commissioner of Insurance of the State of North Dakota do hereby certify that  
I have compared the annexed copy of the Report of Examination of the

**Heart of America HMO**

**Rugby, North Dakota**

as of December 31, 2002, with the original on file in this Department and that the same is a  
correct transcript therefrom and of the whole of said original.

IN WITNESS WHEREOF, I have hereunto  
set my hand and affixed my official seal at my  
office in the City of Bismarck, this \_\_\_\_\_ day of  
\_\_\_\_\_, 2004.

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Jim Poolman  
Commissioner of Insurance

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Rugby, North Dakota  
December 30, 2003

Honorable Alfred W. Gross  
Chair, Financial Condition Committee  
Subcommittee, NAIC  
Secretary, Southeastern Zone, NAIC  
Commissioner  
Bureau of Insurance  
Commonwealth of Virginia  
P.O. Box 1157  
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Honorable Jim Poolman  
Chair, Midwestern Zone  
Commissioner of Insurance  
North Dakota Department of Insurance  
600 East Boulevard  
Bismarck, ND 58505-0320

Dear Commissioners:

Pursuant to your instructions and the statutory requirements of the State of North Dakota, a statutory examination has been made of the books, records, and financial condition of

**Heart of America HMO  
810 South Main  
Rugby, North Dakota 58368**

and the report thereon is respectfully submitted. Heart of America HMO, hereinafter referred to as the "Company", was last examined as of December 31, 1997, by examiners of the North Dakota Insurance Department.

## **SCOPE OF STATUTORY EXAMINATION**

This examination was a financial condition examination conducted in accordance with N.D. Cent. Code § 26.1-18.1-18 and observed guidelines and procedures contained in the NAIC *Financial Condition Examiners Handbook*. The examination was conducted to determine the Company's financial condition, its compliance with statutes, and to review the corporate affairs and insurance operations. This statutory examination covers the period from January 1, 1998, to and including December 31, 2002, including any material transactions and/or events occurring subsequent to the examination date and noted during the course of this statutory examination.

Work papers provided by the Company's independent auditor, EideBailly, LLP, were reviewed and where deemed appropriate certain procedures and conclusions documented in those work papers have been relied upon and copied for inclusion into the working papers for this examination.

Examiners from the North Dakota Insurance Department conducted this examination.

All recommendations contained in the prior examination report dated December 31, 1997, have been adequately addressed by the Company except as follows:

<b><u>Recommendation</u></b>	<b><u>Response by Company</u></b>
It is recommended that the Company complete the Notes to the Financial Statement in accordance with the format in Annual Statement Instructions.	The Company did not complete Note 18 and Note 22a in accordance with <i>NAIC Annual Statement Instructions</i> .

## **HISTORY**

The Company was incorporated January 19, 1978, pursuant to the North Dakota Nonprofit Corporation Act as a nonprofit corporation. The original name of the Company was Hub of America HMO Planning Council. On November 30, 1979, the Articles of Incorporation were amended which had the effect of bringing the corporation also under the provision of N.D. Cent. Code Chapter 26-38 and Public Law 93-222. On February 24, 1982, the Company amended the Articles changing the name of the Company to Heart of America HMO.

The purpose of the Company is to develop and operate an HMO, to promote the general and social welfare of the citizens of North Dakota within the HMO market area, to improve the availability and accessibility of quality health care and health services, to provide and assist in the implementation of comprehensive health planning through cooperation with municipal, county, state, and federal agencies, and to do anything and everything necessary, proper, convenient, suitable, and incidental to the above-stated purposes or which may be done by a nonprofit corporation.

The Company is exempt from the payment of federal income taxes under the provisions of Internal Revenue Code Section 501(c)(4).

N.D. Cent. Code § 26.1-18.1-12(1)(c) provides that health maintenance organizations licensed before August 1, 1993, and licensed only in the State of North Dakota must maintain the minimum net worth requirements in effect at the time N.D. Cent. Code Chapter 26.1-18.1 became law. The Company has no net worth requirement since it was chartered in 1982 when no net worth was required for health maintenance organizations.

The Company is subject to the risk-based capital requirements for health organizations under N.D. Cent Code Chapter 26.1-03.2, which became effective August 1, 1999.

### **Surplus Notes**

Effective November 1, 1999, the Company issued two \$250,000 surplus notes, one to Johnson Clinic, P.C. and one to Heart of America Medical Center. The terms of the notes provide for interest at 8.25% per annum, with interest and principal payments payable semi-annually on May 1 and November 1 of each year, with the first interest and principal payment to begin on May 1, 2000, and continuing until October 31, 2004, when all principal and interest shall be paid in full.

All principal and interest payments require the prior approval of the Commissioner.

The Company did not make any interest or principal payments on the surplus notes during the examination period.

## **MANAGEMENT**

### **Membership**

The Bylaws provide that membership in this organization shall be open to providers and enrollees in the health maintenance organization.

Membership for providers shall be obtained by contracting with the Company to provide health care services to enrollees.

Membership as enrollees shall be obtained by making application for membership to the Company and obtaining approval for membership.

Subscribers or a subscriber's spouse are the only persons entitled to vote in annual meetings and special meetings of the corporation. Only one vote will be permitted per contract. A subscriber is the person in whose name a benefit contract is issued by the Company.

### **Board of Directors**

The Bylaws provide that a Board of Directors of 11 members shall manage the business of the corporation.

There shall be two classes of directors: consumer directors and provider directors. A consumer director shall be nominated by the Board of Directors and may be a subscriber or a subscriber's spouse; however, no individual shall be eligible as a consumer director if such person is:

- In an occupation which involves, or before retirement involved, the administration of health activities or the providing of health services; and/or
- Employed by a hospital, clinic, nursing home, or boarding care home.

A provider director is any director elected by the health care providers who have contracted with the Company to provide health care services.

Seven of the directors shall be elected as consumer members and only subscribers shall be allowed to vote on the election of the consumer representatives of the Board.

Four of the directors shall be provider members. One of the provider members shall represent and will be elected from the personnel or Board of Directors of the Good Samaritan Hospital

Association, Rugby, North Dakota. Two of the provider members shall represent and will be elected from the personnel of the Johnson Clinic, P.C., Rugby, North Dakota, with the requirement that one of the two be a physician. One of the provider members shall represent and will be elected from the personnel of the Trinity Medical Group or Trinity Hospital, Minot, North Dakota. Term limits will not apply with the provider members.

Directors shall be elected at the annual meeting to three-year terms. No person shall be eligible to serve as a director for more than two consecutive three-year terms. However, a director who has served for two consecutive three-year terms may be eligible for reelection after having been off the board for one year.

Directors serving at December 31, 2002, were as follows:

<u>Name</u>	<u>Classification</u>	<u>Term Expires</u>	<u>Business Affiliation</u>
Jerry Jurena Rugby, ND	Provider Director	2006	Administrator, Heart of America Medical Center
Ronald Skipper M.D. Rugby, ND	Provider Director	2006	Physician, Johnson Clinic, P.C.
Teri Mostad, M.D. Minot, ND	Provider Director	2005	Physician, Trinity Medical Group
Carol Schwan Rugby, ND	Provider Director	2005	Administrator, Johnson Clinic, P.C.
Gayle Schneibel Rugby, ND	Consumer Director	2004	Retired
Joe Hoffert Rugby, ND	Consumer Director	2005	Business Manager
Rob St. Michel Rugby, ND	Consumer Director	2005	Business Owner
Dave Trottier Rugby, ND	Consumer Director	2005	Business Owner
Mike Heidlebaugh Rugby, ND	Consumer Director	2006	Farming
Mark Schaan Rugby, ND	Consumer Director	2004	Farming
Carol Miller Rugby, ND	Consumer Director	2004	Teacher

### **Officers**

The Bylaws provide that the Company's officers shall be a President, a Vice President, and a Secretary, all of whom shall be elected by the Board of Directors at its annual meeting.

The Bylaws also provide for the Board of Directors to appoint an Executive Director and a Medical Director.



The officers duly elected or appointed by the Board of Directors and holding office at December 31, 2002, were as follows:

<u>Name</u>	<u>Title</u>
Jerry Jurena	President
Mark Schaan	Vice President
Rob St. Michel	Secretary
Mary Ann Jaeger	Executive Director
Dr. Phil Sedo	Medical Director
Carol Berg	Assistant Medical Director

### **Committees**

The Bylaws provide that all committee members shall be appointed by the President with approval of the Board of Directors and shall serve for one year or less if terminated sooner by the Board.

There were two committees active during the period covered by this examination, the Executive Committee and the Budget Committee.

## **CONFLICT OF INTEREST**

The Company has an established procedure which requires a disclosure to the Board of Directors of any material interest or affiliation on the part of its officers, directors, or responsible employees which is in conflict or likely to conflict with the official duties of such person.

The conflict of interest statements were reviewed and no conflicts were noted which would adversely affect the Company.

## **CORPORATE RECORDS**

### **Membership**

The Bylaws provide that the annual meeting of the Company shall be held at such time and place as determined by the Board of Directors, but in no event later than April 30 of each year.

### **Board of Directors**

The Bylaws provide that the Board of Directors shall hold meetings at least quarterly, or as may be set forth from time to time by the Board of Directors.

The minutes of the membership, the Board of Directors, and committees for the period under examination were read. The minutes of the various meetings indicate that meetings were well attended and held in accordance with the Bylaws.

## **Amendments to Articles of Incorporation and Bylaws**

The following amendments to the Bylaws were adopted by the Board of Directors during the period under review:

1. September 9, 1998
  - Restated various articles of the Bylaws
2. September 17, 2001
  - Article VIII.d.(2) Provider Members - Changed the requirement that one of the Provider Members shall be chosen from the personnel of the Medical Arts Clinic to the personnel of the Trinity Medical Group or Trinity Hospital, Minot, North Dakota.

## **AFFILIATED COMPANIES**

The Company was not a member of an insurance holding company system at December 31, 2002.

The Company was affiliated with the Johnson Clinic, P.C. and Heart of America Medical Center through Board membership and surplus note transactions. The Company also has capitation agreements with Johnson Clinic, P.C. and Heart of America Medical Center which are described under a subsequent caption of this report.

## **FIDELITY BOND AND OTHER INSURANCE**

The Company is protected against loss from fraudulent or dishonest acts of its employees by a commercial blanket bond providing coverage in the amount of \$100,000. The amount of the bond met the minimum amount suggested in the NAIC's *Financial Condition Examiners Handbook*.

The Company also had in force policies covering directors and officers liability, errors and omissions, and a professional office package policy covering office contents.

## **PENSION, STOCK OWNERSHIP, AND OTHER INSURANCE PLANS**

The Company reimburses employees who work more than 1,000 hours in a calendar year for the purchase of a qualified IRA, up to 6% of the employee's salary, up to a maximum of \$1,000. During the period under examination the Company reimbursed employees as follows for IRA purchases:

1998	\$3,822
1999	\$3,989
2000	\$4,062
2001	\$4,255
2002	\$5,369

## **STATUTORY DEPOSITS**

Deposits held by or pledged to regulatory agencies at December 31, 2002, are as follows:

State	Type of Asset	Fair Value	Statement Value
North Dakota	Certificates of Deposit	\$363,223	\$363,223

The deposit held by the State of North Dakota is held pursuant to N.D. Cent. Code §§ 26.1-18.1-12(2) and 26.1-18.1-13.

## **TERRITORY AND PLAN OF OPERATION**

### **Territory**

The Company is authorized to transact business in the following North Dakota counties:

Benson	Bottineau	Burke	McHenry	Mountrail	Divide
Renville	Rolette	Pierce	Towner	Ward	McKenzie
Eddy	McLean	Sheridan	Wells	Williams	

The Company did not include the counties of Williams, Divide and McKenzie in the list of service areas in which the Company is licensed to operate in General Interrogatory No. 10. **It is recommended that the Company add the counties of Williams, Divide and McKenzie to the list of service areas reported in General Interrogatory No. 10, Part 2, of the Annual Statement.**

### **Plan of Operation**

The Company contracts with hospitals and physicians on a fee for service and capitation basis for services provided to the Company's members. In 2002, the costs for capitation arrangements comprised approximately 40% percent of the Company's 2002 hospital and medical costs.

The Company's enrollment at December 31, 2002, consisted of nine large groups (over 10 members) and approximately 30 small groups. The large groups include the Heart of America Medical Center group which consisted of approximately 310 members, and the Johnson Clinic, P.C. group which consisted of approximately 149 members at December 31, 2002.

The Company also had approximately 1,186 individual members at December 31, 2002.

## **PROVIDER CONTRACTS**

### **Capitation Contracts**

The Examiner reviewed the capitation contracts for hold harmless provisions, services to be provided, payment amounts, risk mechanisms, and effective and termination dates with no differences noted.

The following is a summary of the significant capitation agreements in effect at December 31, 2002:

Johnson Clinic Professional Corporation - Medicare Beneficiaries

In 2002, the Company paid Johnson Clinic, P.C. a capitation payment of \$73 for each member enrolled for that month. The capitation fee was payable on or about the 10<sup>th</sup> day of each month. The total amount paid to Johnson Clinic, P.C. in 2002 for Medicare members was \$564,144.

The agreement shall be automatically renewed and continue in effect from year to year unless terminated on its anniversary date by either party by written notice given at least 90 days in advance of such termination.

Johnson Clinic Professional Corporation – Non Medicare

Effective January 1, 2001, the Company entered into a medical service agreement with Johnson Clinic, P.C. to provide for medical and surgical services to members of the Company. The Company agrees to pay to the Clinic an amount equal to the capitation fee on or about the 10<sup>th</sup> day of each month.

The agreement shall be automatically renewed and continue in effect from year to year unless terminated on its anniversary date by either party by written notice given at least 90 days in advance of such termination.

In 2002, the Company paid the Johnson Clinic, P.C. a capitation payment of \$26.65 for each member enrolled for that month. The total amount paid to Johnson Clinic, P.C. in 2002 for non-Medicare members was \$474,770.

Heart of America Medical Center

Effective April 1, 2000, the Company entered into an agreement with Heart of America Medical Center covering health services provided to members of the Company. The agreement continues annually beginning on January 1 of each year unless terminated by notice received not less than 90 days prior to the expiration of each term.

The capitation rate in effect in 2002 was \$37.94 for the high option and \$36.93 for the low option per member per month. The total amount paid in 2002 to the Heart of America Medical Center was \$600,860.

Dakota Eye Institute, P.C.

Effective January 1, 1997, the Company entered into an ophthalmology services agreement with the Dakota Eye Institute, P.C. The Company agrees to pay to the Institute an amount equal to the capitation fee not later than the 15<sup>th</sup> day of each month. The total amount paid in 2002 to Dakota Eye Institute was \$92,082.

The agreement shall be automatically renewed and continue in effect from year to year unless terminated by either party by written notice given at least 60 days in advance of such intended termination date.

**PENDING LITIGATION**

The Company is a defendant in a lawsuit filed in North Dakota's Northeast Judicial District Court in June 2003. According to the Company, settlements, if any, awarded against the Company as result of this lawsuit are covered by its errors and omissions policy which has a \$25,000 deductible. The lawsuit involves events occurring in 2001.

## CONTINUATION OF BENEFITS

N.D. Cent. Code § 26.1-18.1-12(5) requires a health maintenance organization to have a plan in place for handling insolvency which allows for continuation of benefits for the duration of the contract period for which premiums have been paid and continuation of benefits to members who are confined on the date of insolvency in an inpatient facility until their discharge or expiration of benefits. The Company did not have such a plan in place and was not in compliance with N.D. Cent. Code § 26.1-18.1-12(5) at December 31, 2002.

**It is recommended that the Company adopt a plan for providing continuation of benefits as required by N.D. Cent. Code § 26.1-18.1-12 (5).**

## REINSURANCE

The following is a summary of the reinsurance treaties in force at December 31, 2002:

### Ceding Contracts:

- |    |            |   |                    |
|----|------------|---|--------------------|
| 1. | Type:      | Excess of Loss                                  |                    |
|    | Reinsurer: | Allianz Life Insurance Company of North America |                    |
|    | Scope:     | Commercial HMO – Rugby, ND members              |                    |
|    | Retention: | \$30,000 Hospital                               | \$15,000 Physician |

Coverages:

- A. Percentages Payable for Eligible Expenses for Covered Acute Care including transplant care for organ, bone marrow or peripheral stem cell transplant:
- |  |     |
|--|-----|
| • Performed in LifeTrac Network and paid at approved rate      | 90% |
| • Performed outside LifeTrac Network and paid at approved rate | 80% |
| • If paid at other than the above                              | 50% |
- B. Percentages Payable for eligible expenses for Sub-Acute Care, Outpatient Care, Professional Care and All Other Eligible Expenses 90%
- C. Limits for Covered Acute Care:
- |  |
|--|
| • Facilities: Heart of America Medical Center - \$1,000 ICU/NICU/CCU per diem<br>\$1,000 Medical/Surgical per diem |
| • Covered Acute Care: Maximum Daily Rate - \$4,000   |

D. Limits for Sub-Acute Care:

- \$500 per day with a maximum of 40 days per contract year in a facility
- \$250 per day with a maximum of 40 days per contract year in a home setting

E. Limits for Outpatient Care:

- Lesser of 65% of billed charges or \$2,500 per day

F. Limits for Professional Care:

- 150% of geographically adjusted Medicare allowable
- 75% of billed charges with no Medicare Allowable amount

G. Limits for Other Eligible Expenses:

- Durable Equipment – adjusted Medicare allowable
- Prescription Drugs – 100% of Medicare allowable or 55% of billed charges with no Medicare allowable amount available. \$25,000 limit per contract year in home setting or self administered.

Premium:

- Hospital Premium \$9.71 per member per month
- Professional Premium \$1.33 per member per month

Effective Date: August 1, 2002

Termination: Twelve months from the effective date or upon nonpayment of premium, material breach of agreement or declaration of receivership whichever is earliest.

Type: Excess of Loss

Reinsurer: Allianz Life Insurance Company of North America

Scope: Commercial HMO - City of Minot enrollees

Retention: \$30,000

Coverage:

A. Percentages Payable for Eligible Expenses for Covered Acute Care including transplant care for organ, bone marrow or peripheral stem cell transplant:

- Performed in LifeTrac Network and paid at approved rate 90%
- Performed Outside LifeTrac Network and paid at approved rate 80%
- If paid at other than the above 50%

B. Percentages Payable for Eligible Expenses for Outpatient Care, Professional Care and Other Eligible Expenses 90%

C. Limits for Covered Acute Care:

- Facilities: Heart of America Hospital - \$1,000 each inpatient day
- Covered Acute Care: Maximum Daily Rate - \$4,000

D. Limits for Outpatient Care:

- Heart of America Hospital - \$1,000 per day
- All other Facilities – lesser of 72.5% of billed charges or \$2,500 per day

E. Limits for Professional Care:

- 150% of geographically adjusted Medicare allowable
- 75% of billed charges with no Medicare allowable amount

F. Limits for Other Eligible Expenses: Prescription drugs, chemotherapy drugs and blood products administered and billed by a physician:

- 150% of geographically adjusted Medicare allowable as of date of service
- 75% of billed charges for services with no Medicare allowable amount available

Premium: \$21.37 per member per month

Effective Date: January 1, 2002

Termination: Twelve months from the effective date or upon nonpayment of premium, material breach of agreement or declaration of receivership whichever is earliest.

## **ACCOUNTS AND RECORDS**

A trial balance as of December 31, 2002, was obtained and traced to the appropriate schedules of the Company's 2002 Annual Statement. The Company's ledgers are maintained electronically. Revenues and expenses were test checked to the extent deemed necessary.

The Company is audited annually by an outside firm of independent certified public accountants. The work papers of this firm were made available to the Examiners and were used to the extent deemed appropriate for this examination.

The Company uses an electronic data processing system to process the majority of its critical applications (e.g., general ledger, premium processing, and claims processing). The Company's computer hardware consists of approximately five personal computers, four of which are linked to a mainframe computer located in the Heart of America Medical Center building. The Company has used the same application program for over 15 years. The program was developed and is maintained by a firm located in Bismarck, North Dakota.

A review was made of the 2002 Statutory Annual Statement with the following areas requiring comment:

1. The Notes to the Financial Statement did not always contain the information required by NAIC's *Annual Statement Instructions*. The following exceptions were noted:
  - Note 18 - The Company did not provide required information regarding the profitability of the Medicare Cost Contract under Note 18.
  - Note 22.A - The Company did not report approximately \$70,000 of unsecured reinsurance recoverable from Allianz Life Insurance Company of North America.

**It is recommended that the Company disclose unsecured reinsurance recoverables and provide information regarding the Medicare Cost Contract in the "Notes to the Financial Statement" as required by NAIC *Annual Statement Instructions*.**

2. The Company reported the liability for reported claims on line 1.1 of Part 2A at net rather than gross because it did not report reinsurance recoverable on unpaid claims on line 1.3 of Part 2A of its 2002 Annual Statement. Reporting reserves at net on line 1.1 did not impact surplus but did understate the reserve for gross reported claims and reinsurance recoverable on reported claims by approximately \$50,000 at December 31, 2002.

**It is recommended that the Company complete Part 2A of the Underwriting and Investment Exhibit in accordance with NAIC *Annual Statement Instructions* and SSAP No. 61, paragraph 22.a, by reporting unpaid claims at gross on line 1.1 and reducing that amount by reinsurance recoverable on unpaid claims on line 1.3 instead of reporting unpaid claims at net in the exhibit as currently reported by the Company.**

## **FINANCIAL STATEMENTS**

The Financial Statements section includes the following:

Statement of Assets, Liabilities, Capital and Surplus, December 31, 2002  
Statement of Revenue and Expenses for the Year Ending December 31, 2002  
Reconciliation of Capital and Surplus Account, January 1, 1998 Through December 31, 2002  
Analysis of Examination Changes



**Heart of America HMO**  
**Statement of Assets, Liabilities, Capital and Surplus**  
**December 31, 2002**

	<b>Assets</b>	<b>Nonadmitted Assets</b>	<b>Net Admitted Assets</b>
Bonds	\$ 9,566		\$ 9,566
Common Stocks	180,517	\$73,595	106,922
Cash	846,294		846,294
Accident and Health Premiums Due and Unpaid	13,534		13,534
Amounts Recoverable from Reinsurers	21,724		21,724
Investment Income Due and Accrued	765		765
Amounts Receivable Relating to Uninsured A & H Plans	68,266		68,266
Furniture and Equipment	7,858	7,858	
Electronic Data Processing Equipment	2,150		2,150
Prepaid Insurance	16,813	16,813	
Totals	<u>\$1,167,487</u>	<u>\$98,266</u>	<u>\$1,069,221</u>

**Heart of America HMO**  
**Statement of Assets, Liabilities, Capital and Surplus**  
**December 31, 2002**

	<u>Covered</u>	<u>Uncovered</u>	<u>Total</u>
Claims Unpaid	\$392,691	\$53,002	\$ 445,693
Unpaid Claims Adjustment Expenses	35,000		35,000
Premiums Received in Advance	72,700		72,700
General Expenses Due or Accrued	23,601		23,601
<b>TOTAL LIABILITIES</b>	<u>\$523,992</u>	<u>\$53,002</u>	<u>\$ 576,994</u>
Surplus Notes			\$ 500,000
Unassigned Funds			<u>(7,773)</u>
<b>TOTAL CAPITAL AND SURPLUS</b>			<u>\$ 492,227</u>
<b>TOTAL LIABILITIES, CAPITAL AND SURPLUS</b>			<u><u>\$1,069,221</u></u>

**Heart of America HMO**  
**Statement of Revenue and Expenses**  
**Year Ending December 31, 2002**

	<u>Uncovered</u>	<u>Total</u>
Net Premium Income		\$4,859,630
Medical and Hospital:		
Hospital/Medical Benefits		\$3,566,300
Outside Referrals	\$689,988	689,988
Emergency Room and Out-of-Area		53,045
Prescription Drugs		1,594
Durable Medical Equip. & Ambulance		96,036
	<hr/>	<hr/>
Subtotal	\$689,988	\$4,406,963
Net Reinsurance Recoveries		87,995
	<hr/>	<hr/>
Total Medical and Hospital	\$689,988	\$4,318,968
General Administrative Expenses		472,219
	<hr/>	<hr/>
Total Underwriting Deductions	\$689,988	\$4,791,187
Net Underwriting Gain or (Loss)		68,443
Net Investment Income Earned		23,880
Net Realized Capital Gain or (Loss)		(11,100)
NET INVESTMENT GAIN OR (LOSS)		12,780
		<hr/>
Net Income or (Loss) Before Federal Income Taxes		\$81,223
		<hr/>
Federal Income Taxes Incurred		0
NET INCOME		<u><u>\$81,223</u></u>

**Heart of America HMO**  
**Reconciliation of Capital and Surplus Account**  
**January 1, 1998 through December 31, 2002**

	<b>1998</b>	<b>1999</b>	<b>2000</b>	<b>2001</b>	<b>2002</b>
Reserves and Unassigned Funds December 31, Prior Year	\$398,541	\$304,834	\$348,640	\$376,343	\$453,596
Increase in Surplus Notes		500,000			
Net Income or (Loss)	(79,038)	(447,567)	53,584	59,683	81,223
Net Unrealized Capital Gain or (Loss)	(16,036)	(9,397)	(26,044)	26,715	21,003
Change in Nonadmitted Assets	1,367	770	163	(9,145)	3,734
Exam Adjustment to Common Stock					(73,595)
Exam Adjustment to Uninsured A&H Receivable					6,266
Net Change in Capital and Surplus	<u>\$(93,707)</u>	<u>\$43,806</u>	<u>\$27,703</u>	<u>\$77,253</u>	<u>\$38,631</u>
Reserves and Unassigned Funds, December 31, Current Year	<u>\$304,834</u>	<u>\$348,640</u>	<u>\$376,343</u>	<u>\$453,596</u>	<u>\$492,227</u>

**Heart of America HMO**  
**Analysis of Examination Changes**  
**for the Year Ended December 31, 2002**

Description	Annual Statement	Per Examination	Surplus Change	
			Increase	Decrease
<b><u>Assets</u></b>				
Bonds	\$0	\$ 9,566	\$ 9,566	
Common Stocks	180,517	106,922		\$(73,595)
Cash	855,860	846,294		(9,566)
Health Care Receivables	62,000	0		(62,000)
Amounts Recoverable from Reinsurers	17,800	21,724	3,924	
Amounts Receivable Relating to Uninsured A&H Plans	0	68,266	68,266	
<b><u>Liabilities</u></b>				
Unpaid Claim Adjustment Expenses	0	35,000		(35,000)
General Expenses Due or Accrued	20,352	23,601		(3,249)
			<u>\$81,756</u>	<u>\$(183,410)</u>
Surplus Per Annual Statement		\$593,881		
Surplus Per Examination		<u>492,227</u>		
Decrease Per Examination		<u>\$101,654</u>		

## COMMENTS ON FINANCIAL STATEMENTS

### **Bonds**

In 2000, the Company wrote down the value of a bond to fair value and adjusted the book value to fair value annually thereafter until 2002 when the Company sold the issue. SSAP No. 26, paragraph 8, states that after a bond is written down, the new cost basis shall not be changed for subsequent recoveries in fair value.

**It is recommended that the Company record book value adjustments to bonds in accordance with SSAP No. 26, paragraph 8, which states that after a bond is written down, the new cost basis shall not be changed for subsequent recoveries in fair value.**

The Company incorrectly classified a 30-month term certificate of deposit with a book value of \$9,566 as cash in its 2002 Annual Statement. According to *NAIC Annual Statement Instructions*, a certificate of deposit with a maturity date greater than one year from the acquisition date shall not be classified as cash. SSAP No. 26, paragraph 2, defines bonds to include certificates of deposit that have a fixed schedule of payments and a maturity date in excess of one year from the date of acquisition.

**It is recommended that the Company record certificates of deposit with terms longer than one year from date of acquisition in Schedule D as bonds rather than in Schedule E as cash.**

### **Common Stocks**

At December 31, 2002, the Company owned 18,088 common shares in Investors Real Estate Trust. The shares were valued at \$180,517 which represented 17% of admitted assets at December 31, 2002. The investment in Investors Real Estate Trust exceeded statutory limitations at December 31, 2002.

N.D. Cent. Code § 26.1-05-19(21)(a) restricts investments in preferred, guaranteed, and common stocks issued or guaranteed by a single person to an amount not in excess of 3% of the insurance company's admitted assets. N.D. Cent. Code § 26.1-05-19(33), commonly known as the basket clause, provides additional investment authority allowing insurers to invest funds in investments not specifically authorized elsewhere to an amount that does not exceed either 7% of the company's admitted assets, or the amount equal to the company's capital and surplus in excess of the minimum capital and surplus required by law, whichever is less.

Using the authority allowed under N.D. Cent. Code §§ 26.1-05-19(21)(a) and 26.1-05-19(33), the Examiners determined the admitted value of Investors Real Estate Trust to be \$106,922 or \$73,595 less than the \$180,517 value reported by the Company in its 2002 Annual Statement.

### **Amounts Recoverable from Reinsurers**

Amounts recoverable from reinsurers for reinsurance recoverable on paid claims was determined by this examination to be \$21,724 or \$3,924 more than the amount reported by the Company in its 2002 Annual Statement.

### **Amounts Receivable Relating to Uninsured A&H Plans**

The receivable for the Medicare cost contract was determined to be \$68,266 or \$6,266 more than the amount reported by the Company in its 2002 Annual Statement.

**It is recommended that the Company classify receivables due under the Medicare cost contract on line 16 of page 2 of the Annual Statement as “Amounts Receivable Relating to Uninsured A&H Plans” rather than on line 11 as “Health Care Receivables”.**

### **Claims Unpaid**

The Examiners reviewed subsequent claim payments through September 30, 2003, to assess the adequacy of the reserve for claims payable at December 31, 2002. The claim run-off analysis through that date indicated that the Company's December 31, 2002, reserve for claims unpaid was adequate.

### **Unpaid Claim Adjustment Expenses**

The Company did not establish a liability for unpaid claims adjustment expenses at December 31, 2002, on page 3 of its 2002 Annual Statement and did not allocate a portion of its general expenses to Claim Adjustment Expenses (column 1) in Part 3, Analysis of Expenses, of its 2002 Annual Statement.

SSAP No. 55, paragraph 4, provides that claim adjustment expenses shall be recognized as an expense when a covered or insured event occurs and liabilities shall be established for any unpaid claim adjustment expenses.

The Examiner established a \$35,000 liability for unpaid claim adjustment expenses at December 31, 2002, based on an analysis of industry statistics.

**It is recommended that the Company establish a liability for Unpaid Claims Adjustment Expenses on an annual basis and allocate a portion of its general expenses to Claim Adjustment Expenses (column 1) in Part 3 - Analysis of Expenses.**

### **General Expenses Due of Accrued**

The Company reimburses employees for the purchase of a qualified IRA up to 6% of the employee's annual salary up to a maximum of \$1,000. The Company did not establish a liability at December 31, 2002, for IRA reimbursements earned by employees in 2002 but unpaid at year end.

In accordance with SSAP No. 5, the Examiners established a \$3,249 liability as of December 31, 2002, for the Company's share of unpaid IRA contributions earned by Company employees in 2002.

**It is recommended that the Company establish a liability for its share of IRA contributions that have been earned by Company employees during the current calendar year but which were unpaid as of year end.**

## CONCLUSION

The financial condition of the Company as of December 31, 2002, as determined by this examination is summarized as follows:

ADMITTED ASSETS		<u>\$1,069,221</u>
Total Liabilities	\$576,994	
Net Worth	<u>492,227</u>	
LIABILITIES AND NET WORTH		<u>\$1,069,221</u>

Since the last examination conducted as of December 31, 2002, the Company's admitted assets have increased \$50,803, its total liabilities have decreased \$42,883, and its net worth has increased by \$93,686.

In addition to the undersigned, Rhoda Sautner, CPA, Examiner with the North Dakota Insurance Department, participated in this examination.

Respectfully submitted,

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David Weiss, CFE  
Examiner  
N.D. Insurance Department



## RECOMMENDATIONS

It is recommended that the Company add the counties of Williams, Divide and McKenzie to the list of service areas reported in General Interrogatory No. 10, Part 2, of the Annual Statement.

It is recommended that the Company adopt a plan for providing continuation of benefits as required by N.D. Cent. Code § 26.1-18.1-12(5).

It is recommended that the Company disclose unsecured reinsurance recoverables and provide information regarding the Medicare Cost Contract in the "Notes to the Financial Statement" as required by NAIC *Annual Statement Instructions*.

It is recommended that the Company complete Part 2A of the Underwriting and Investment Exhibit in accordance with NAIC *Annual Statement Instructions* and SSAP No. 61, paragraph 22.a, by reporting unpaid claims at gross on line 1.1 and reducing that amount by reinsurance recoverable on unpaid claims on line 1.3 instead of reporting unpaid claims at net in the exhibit as currently reported by the Company.

It is recommended that the Company record book value adjustments to bonds in accordance with SSAP No. 26, paragraph 8, which states that after a bond is written down, the new cost basis shall not be changed for subsequent recoveries in fair value.

It is recommended that the Company record certificates of deposit with terms longer than one year from date of acquisition in Schedule D as bonds rather than in Schedule E as cash.

It is recommended that the Company classify receivables due under the Medicare cost contract on line 16 of page 2 of the Annual Statement as "Amounts Receivable Relating to Uninsured A&H Plans" rather than on line 11 as "Health Care Receivables".

It is recommended that the Company establish a liability for Unpaid Claims Adjustment Expenses on an annual basis and allocate a portion of its general expenses to Claim Adjustment Expenses (column 1) in Part 3 - Analysis of Expenses.

It is recommended that the Company establish a liability for its share of IRA contributions that have been earned by Company employees during the current calendar year but which were unpaid as of year end.